



Office of Governmental Affairs
P.O. Box 942720
Sacramento, CA 94229-2720
Telecommunications Device for the Deaf - (916) 795-3240
(916) 795-3689, FAX 916) 795-3270

April 19, 2006

AGENDA ITEM 15-A

TO: MEMBERS OF THE BOARD OF ADMINISTRATION

- I. SUBJECT:** Senate (S.) 1955 (Michael Enzi, R-WY) –
As Amended March 3, 2006
- Health Insurance Marketplace Modernization and
Affordability Act of 2005
- II. PROGRAM:** Federal Legislation
- III. RECOMMENDATION:** Oppose
- This bill could adversely affect CalPERS' risk pool and
result in adverse selection and insurance market
segmentation.

IV. ANALYSIS:

S. 1955 would enact the "Health Insurance Marketplace Modernization and Affordability Act of 2006" through amendments to the Employee Retirement Income Security Act (ERISA) of 1974 and the Public Health Service Act (PHSA) that would: permit creation of small business health plans; establish federal regulation of small group health insurance coverage superseding State law; and allow insurers in all markets to offer "affordable plans" that do not conform to State-mandated benefits.

Background

According to a press release by Senator Enzi, the intent of S. 1955 is to enhance the market leverage of small groups as well as individual policy holders; give associations a meaningful role on a level playing field with other group health plans; streamline the current mixture of varying State regulation; preserve the primary role of the States in health insurance oversight and consumer protection; make lower-cost health plan options available; and achieve meaningful reform without a big price tag.

The House passed H.R. 525 (Sam Johnson, R-TX) which is similar to S. 1955 in that it amends ERISA to allow small businesses to band together to join association health plans (AHPs). These AHPs are exempt from state regulatory oversight and insurance standards, have broad discretion to design benefit packages, and are not required to follow state laws mandating the inclusion of specified benefits and services.

If S. 1955 passes, it would go to a Conference Committee with H.R. 525.

Mechanics of the Marketplace

Large employers are able to pool resources to purchase health insurance for their employees more easily than small employers. Because small businesses have been considered more risky to insure, insurers developed strategies to sort small businesses into risk pools dependent upon employee health status. To maintain profitability, insurers charge higher rates to smaller firms and firms with older, less-healthy employees, or avoid them altogether.

Health insurance is generally regulated by the States. To help level the playing field, California developed laws to help small business owners purchase insurance for their employees. These laws included protections for small business owners and employees from unpredictable premiums and assured that risk is equitably spread among small employers to prevent insurers from selectively insuring good risks versus bad risks and redlining older employees with health challenges. California has also enacted laws that ensure that health insurance be of value by guaranteeing access to certain medical treatments and providers.

Proposed Changes

S. 1955 would allow associations to independently pool their members to buy health coverage under Small Business Health Plans (SBHPs), but would not allow them to establish self-insured plans. The bill also would supersede state laws in various areas of health insurance requirements. The bill has three parts, Titles I, II and III which are outlined below.

Title I – Small Business Health Plans

- Amends ERISA to allow small business employers who are members of specified associations to combine their employees into a single health care purchasing pool as SBHPs. The SBHPs could purchase fully-insured group health plan coverage across State lines and not be subject to State insurance mandates from licensed insurers;
- Requires SBHPs that offer “basic option” coverage varying from State mandates to also offer an “enhanced option” which includes the covered benefits offered in a State employee health plan in one of the five most populous States;

- Requires SBHPs to obtain federal certification, be governed by a board of trustees with complete fiscal control, and be established for more than three years for purposes other than pooling healthcare coverage, and not condition association membership or coverage on health status;
- Permits regulatory oversight to remain with the States, but would enact uniform standards across State lines; and
- Specifies the case characteristics that a small employer carrier may use are limited to age, gender, industry, geographic area, family composition, group size, and participation in wellness programs unless the carrier obtains approval of the applicable State authority. California allows insurance companies to set premium rates based on only three risk factors: age, family composition, and geographic region.

Title II – Market Relief

- Amends the PHSA to require broad changes in health insurance regulations. These changes affect individual, small group, and large group markets;
- Requires the Secretary of the Department of Labor (DOL) to issue “Benefit Choice Standards” for “basic” options defined as those that do not comply with state mandated benefits and “enhanced” options which must include, at a minimum, covered benefits offered in a State employee health plan in one of the five most populous states. (Currently those states are California, Texas, Illinois, Florida, and New York.);
- Requires that insurers offering the basic option must offer an enhanced option; and
- Requires the Secretary of Labor to establish federal Model Small Group Rating Rules (MSGRR), in consultation with the National Association of Insurance Commissioners (NAIC), to issue regulations requiring States to adopt the MSGRR or the Transitional Model Small Group Rating Rules, exclusively to rate the small group market. The Secretary will base the MSGRR on the model rules adopted by the NAIC in 1993.

Title III – Harmonization of Health Insurance Laws

- Amends the PHSA to require the Secretary of Labor to establish a Health Insurance Consensus Standards Board (Board) composed of specified members including business, State insurance commissioners, State governors and legislators, consumer advocates, and health insurers. There also would be an advisory panel to provide advice to the Board; and

- Requires the Board to develop recommendations that “harmonize inconsistent State health insurance laws.” These nationally harmonized standards would supersede State laws that relate to various administrative categories such as reporting requirements, claims for benefits, claims payment procedures, and claims appeal procedures.

Legislative History

2005 S 406: “The Small Business Health Fairness Act of 2005” (Olympia Snowe, R-ME) would amend Title I of the ERISA to improve access and choice for entrepreneurs with small businesses with respect to medical care for their employees. In Senate Health, Education, Labor and Pensions Committee. *CalPERS Position: None*

HR 525: “The Small Business Health Fairness Act of 2005” (Sam Johnson, R-TX) would allow the creation of AHPs through which small companies could band together to buy insurance for their employees. Association health plans that cover employees in multiple states would be exempt from many individual state insurance regulations but would be regulated by the Department of Labor. Passed House; in Senate Health, Education, Labor and Pensions Committee. *CalPERS position: None*

2004 HR 4281: “The Small Business Health Fairness Act of 2004” (Sam Johnston, R-TX) would amend the ERISA to provide for establishment and governance of AHPs, whereby exempting AHPs from State regulation of health insurance providers, including State consumer protection laws and State requirements for healthcare benefits to be offered by such entities. Passed House, appended to another bill – Died. *CalPERS position: None*

2003 S 545: “The Small Business Health Fairness Act of 2003” (Olympia Snowe, R-ME) would amend the ERISA to revise provisions relating to access and choice for small business employers with respect to medical care for their employees. Died. *CalPERS position: None*

HR 660: “The Small Business Health Fairness Act of 2003” (Ernie Fletcher, R-KY) would amend the ERISA of 1974 to provide for establishment and governance of AHPs and which meet certain ERISA certification requirements. Would exempt AHPs from State regulation of health insurance providers, including State consumer protection laws and State requirements for health-care benefits to be offered by such entities. Died. *CalPERS position: None*

Issues

1. Arguments by Those in Support

Large corporations and unions can pool resources to obtain competitive rates for members or employees. The small business community and its millions of employees deserve the same opportunity since they are often forced to seek health insurance for their workers as separate entities, making it more expensive and difficult to purchase insurance coverage.

This bill is a critical measure for small, entrepreneurial businesses and would help them to be better equipped to handle rising healthcare costs by pooling their risks. Small businesses will be able to have purchasing power similar to that of large companies and unions. This legislation levels the playing field and allows small businesses to provide their employees with access to high-quality, affordable health care.

U.S. Department of Labor, U.S. Small Business Association, National Federation of Small Business (NFIB), Associated Builders and Contractors (ABC), National Association of Realtors (NAR), U.S. Chamber of Commerce, National Restaurant Association, and the National Association of Wholesalers-Distributors

2. Arguments by Those in Opposition

Opponents assert that this bill would preempt State laws that require insurers to cover preventive healthcare services such as well-child care, cancer screenings, diabetic supplies, mental health services, emergency services, mammography screening, and others.

Opponents also worry that this bill would destroy State-mandated consumer protections that include limiting how much and how often an employer's premiums can increase when an employee gets sick.

The California Insurance Commissioner states in his letter of opposition that this bill will result in a serious disruption of the small group marketplace and will trigger serious problems, such as increased rates for many consumers.

California Department of Insurance, California Attorney General, and the American Federation of State, County and Municipal Employees (AFSCME), AFL-CIO

3. Potential Erosion of CalPERS Risk Pool

The lower cost health insurance products allowed under S. 1955 may attract existing and potential CalPERS contracting agencies and association plans. Although ERISA does not apply to "governmental" employee benefit plans, it is

unclear whether contracting agencies or CalPERS association plans could qualify to form or join SBHPs as provided in the bill. The language does not appear to prohibit this possibility because the description of a qualifying association in the bill is ambiguous. If Title I of S. 1955 is interpreted by the Department of Labor so that public agencies qualify as associations and form or join SBHPs, they may be attracted away from CalPERS.

Additionally, Title II of the bill permits insurers to offer to all healthcare purchasers a basic option with none of the mandated benefits now guaranteed under California law as long as they also offer an enhanced option. While an enhanced option must include mandated benefits, the benefits would not necessarily be equal to those currently provided under California law and there are no limits on cost-sharing (i.e., a plan with a \$4,000 deductible would qualify as the enhanced option). To remain competitive, insurers (including CalPERS health plans) would face pressure to offer the plans allowed under the bill. The availability of these plans in the marketplace may inhibit CalPERS' ability to attract and retain contracting agencies. Erosion of CalPERS membership caused by the bill would have an adverse impact on CalPERS risk pool.

Finally, the availability of these plans may create pressure for the CalPERS Board to offer similar products.

4. Adverse Selection and Insurance Market Segmentation

S. 1955 would create a marketplace environment that would promote adverse selection among groups and market segmentation. Groups that do not envision requiring costly healthcare services likely would opt for the basic option plan while groups expecting high healthcare utilization would be inclined to select the enhanced option plan. The current level playing field within California for health benefits results in less segmentation of the small group insurance market. More segmentation means higher rates for many if not most small businesses that would choose to offer an enhanced option plan.

Under current law, insurance carriers can only offer coverage to local agencies that is community rate-adjusted for the area. Carriers can only vary rates by about +/- 10%. Under this legislation, the rating rules disappear and the insurance carriers will be able to vary rates to local agencies widely by group size, industry, age, etc. This will lead to carriers offering low-premium plans to agencies with young, healthy people and high-premium plans to agencies with older, sicker people.

5. Failure to Address Rising Healthcare Costs

Similar to prior attempts towards health insurance reform, S. 1955 does not address the underlying issue of rising healthcare costs. S. 1955 also detracts

from real reform efforts such as CalPERS Board's Partnership for Change initiative to identify the structural reforms needed to promote higher quality and more cost-effective hospital care.

6. Legislative Policy Standards

The Board's Legislative Policies do not address the issues in this bill. However, staff is recommending an oppose position because the overarching points as summarized from the bill are consistent with the following Health Policy Standards established by the Board:

- Potential negative affect on the stability in CalPERS' risk pool; and
- Mandates a specific benefit design or other proposals that would limit CalPERS Board's discretion in responding to market conditions.

V. STRATEGIC PLAN:

This item is not a product of the CalPERS strategic plan, but an ongoing responsibility of the CalPERS Office of Governmental Affairs.

VI. RESULTS/COSTS:

Costs are not known at this time.

Lisa Marie Hammond, Chief
Office of Governmental Affairs

Terri Westbrook
Assistant Executive Officer
Health Benefits Services

Jarvio Grevious
Deputy Executive Officer
Benefits Administration